

Charitable Remainder Trusts

Introduction

All split interest trusts described in Section 4947(a)(2) of the Internal Revenue Code must file Form 5227, *Split Interest Trust Information Return*, annually to report their financial activities. A split interest trust is one that has both charitable and non-charitable beneficiaries. These non-exempt trusts function as hybrids that retain characteristics of both tax-exempt charitable organizations and private trusts. There are three main types of split interest trusts: charitable lead trusts, pooled income funds, and charitable remainder trusts (CRTs). A charitable lead trusts pays a fixed annuity to a charitable organization over a given period of time, after which the remaining interest is transferred to a non-charitable beneficiary. A pooled income fund, created and maintained by a charitable organization, pays lifetime interest income to its donors, while the remaining interest is kept by the charitable organization. Charitable remainder trusts pay a fixed dollar amount or a percentage of their assets annually to one or more non-charitable beneficiaries. These payments may be for a specified number of years or for the life of the beneficiary. Upon termination of the payments, the remaining interest is transferred to a charitable organization.

There are two primary types of charitable remainder trusts: charitable remainder annuity trusts and charitable remainder unitrusts. Annuity trusts pay their non-charitable beneficiaries a fixed amount annually. This amount is specified when the trust is established, based on the value of the assets initially placed in the trust. In comparison, unitrusts distribute to their non-charitable beneficiaries an amount determined by applying a percentage to the net fair market value of its assets each year. When both types of trusts are terminated, the remaining assets are transferred to a charitable beneficiary of the donor's choice.

In recent years, the number of charitable remainder trusts has increased rapidly. Between 1996 and 1998, the number of CRTs filing Form 5227 rose 19 percent, from 71,251 to 85,060. As the economy and the stock market experienced unprecedented growth during the 1990's, many investors sought ways to shelter record earnings from applicable taxes. CRTs

are just such a vehicle, popular in recent years because the donor receives a tax deduction applicable to the current year's income, based on the amount eventually to be given to the charitable organization.

Beginning in 1999, the Statistics of Income (SOI) Division conducted the first in what is to be a series of studies of charitable remainder trusts. Data were collected for Reporting Year 1998 from Form 5227. Returns were selected for the study based on the fair market value of the assets of the trusts. Annuity trusts whose total assets were greater than \$1.5 million, and unitrusts with more than \$3.0 million in total assets were sampled at 100 percent. Returns for both kinds of trusts whose assets were below the 100-percent sampling threshold were selected using a stratified random sample.

This section presents an article and tables from the first year of the CRT study. For 1998, approximately 85,000 returns were filed by charitable remainder trusts. Unitrusts filed 76.3 percent of the total number of returns, reporting \$8.2 billion in net capital gains (both short- and long-term), and distributing over \$4.4 billion to recipients. The remaining 23.7 percent of returns were filed by annuity trusts, which reported net capital gains of \$0.9 billion and distributions of \$0.7 billion.

Program Developments

Data from 1998 were edited using a Graphical User Interface (GUI) environment. This system, known as a "point-and-click" environment, allowed for a great deal of flexibility within the program. The study's "editors" who input return data and resolve taxpayer reporting inconsistencies were able to take advantage of the system's easily navigated layout, automated features, and quality controls. Beginning with Reporting Year 2000, the study will include data available from all types of trusts filing Form 5227—charitable remainder trusts, pooled income funds, and charitable lead trusts. Also beginning with Reporting Year 2000, the sample will be redesigned to select returns based on the end-of-year book value of total assets, which has been found to be more accurately and consistently reported by Form 5227 filers.

Source: IRS; Compendium of Studies of Tax-Exempt Organizations, 1989-1998; Volume 3, Publication 1416; August 2002